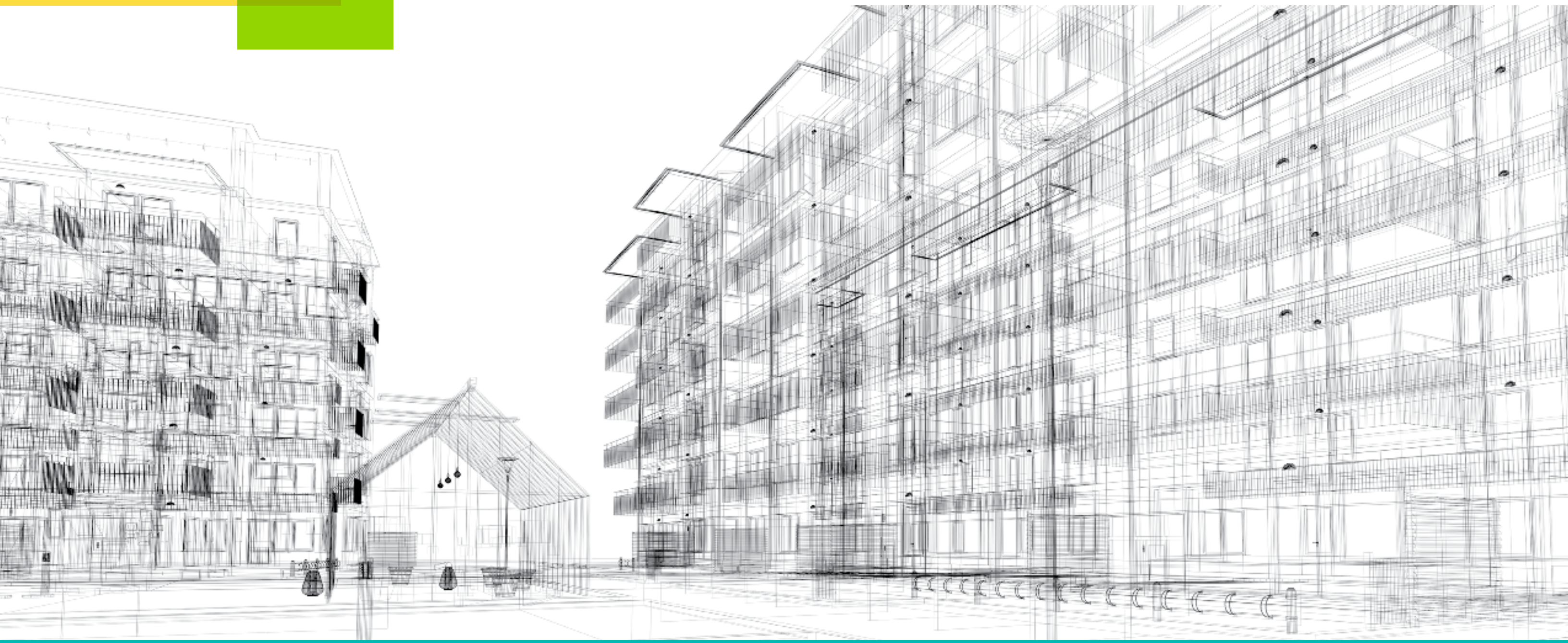


Developing a property? Here's what you need to know at every stage.

The Canadian real estate market presents investors with a wide range of appealing financial opportunities. For both domestic and foreign land developers, a project in Canada has the potential to yield impressive and stable ROI for many years to come. As with any large real estate investment, the keys to success lie in thorough planning, foundational subject matter expertise, and familiarity with the local market regulations.

The decision to develop a property begins with a variety of motivations, depending on the investor. Your unique goals dictate not only the type of property you purchase and build, but also your time commitment, capital budget, and financing.

A property that is developed for the purpose of being quickly sold as a one-time investment is very different than a property that is developed to produce rental income for many years. Gaining a thorough understanding of your "big picture" end goals will help you to choose effectively when faced with all the smaller decisions along the way.

Pre-purchase considerations

Once you have a clear picture of your ultimate goal, there are a few initial questions worth asking:

In what capacity will I be making the purchase?

Will the purchase be made by a corporation, partnership, joint venture, etc?

What is my budget?

Your method of financing and investment goals will determine how much money you want to spend on the initial investment and as well as throughout the project's lifespan.

Who is on my team?

Do you have a team of advisors? You'll need an accountant, architect, lawyer, engineer, surveyor, and town planner to name a few.

Choosing the right site

There are many factors involved in selecting the right property to achieve your goals. Although of course your heart must be in the purchase, it needs to be thoroughly vetted. Consider the following factors:

Risks

For which purpose(s) has the land been zoned? Consider all the factors that could limit your development plans, including natural landscape factors like roadworks, parking, sewage, access to water, vegetation, and the curvature of the land. At this stage, it's wise to conduct some preliminary research yourself first so that you can ask insightful and relevant questions during your initial meetings with your team members

Profit

Now that you have an understanding of the risks, you're better equipped to do the math on the profit. How much money do you think it will cost to develop the project? What do you anticipate it could sell for? What is my timeline to earn the expected profit and do I have a contingency plan if the timing is delayed? Is your capital budget realistic?

Terms

The terms of the deal will determine how quickly you can begin construction. Here's where it's helpful to have your accountant and legal counsel consult. A properly structured deal will result in a profitable investment.

The team at Zeifmans has 60 years of experience assisting our clients in choosing, structuring, and investing in the most profitable land development deals. Let's take a look at the most important factors that we consider when advising our clients throughout each of the 6 development phases.

1 Acquisition

It's critical that the legal ownership of the property is correctly structured. The entity that is meant to hold the property should be the one that buys it, because changing the structure after the fact could trigger unforeseen expenses, such as – land transfer and income taxes that might not otherwise be due.

If you need more time to create the purchasing structure, another option is to include a clause in the deal that states that an entity not yet created may take title to the property on closing. Careful attention should be given to non-residents purchasing the land; if this isn't properly considered, it could lead to a plethora of issues down the road.

Some other acquisition factors to consider include:

Land transfer tax

Ontario land transfer taxes are incurred by the purchaser on closing. The city of Toronto doubles the tax if the property is located in Toronto.

Environmental assessment

It's advisable to obtain an environmental assessment to ensure that there are no environmental issues surrounding the property. This way, you can avoid long term liabilities, or other environmental surprises that could delay the development process.

Transaction due diligence

Due diligence is an investigation or audit of a potential investment or product to confirm all the facts. This process includes the investigation of financial records and compliance history. Essentially, this is the research that is done before entering into an agreement or a financial transaction with another party. No one wants to find out negative details after closing. That's why most land developers will enlist the assistance of accountants or lawyers to perform due diligence, and uncover any findings that could also provide leverage when negotiating a price.

2 Financing

How you choose to finance a land development project can drastically influence your ROI. Different finance options will work best to suit your specific situation depending on the type of property and how long you plan to hold onto it before selling it. Let's examine some of the biggest factors to be aware of when financing a land development project:

Reporting requirements

Often, lenders require audited or reviewed financial statements to be prepared by the borrower. This requirement increases the reporting requirements by the borrower and requires the use of a CPA firm. As an audit can be a time consuming and rigorous process, you

should hire an accounting firm early in the process to ensure the firm knows what is required from it - early in the game.

Covenants and ratios

Often, a lender expects certain ratios, such as a maximum debt to equity ratio, to be met over the duration of the project. Careful planning is required to ensure the ratios are met or you could have your loan called early by the lender.

Interest deductibility

Generally speaking, interest paid on loans is either deductible by the purchasing entity or capitalized to the building. A capital expenditure is a payment for goods or services recorded on the balance sheet, rather than expensed on the income statement. Capital expenditures are added to the cost of the property. If an expense is capitalized, the deduction will be realized at a later point in time.

Loan fees

Loan fees include mortgage applications, appraisal fees, processing, and insurance fees; mortgage guarantee fees; mortgage broker and finder's fees; and legal fees related to mortgage financing. Under income tax law, you can deduct these fees over a period of 5 years, regardless of the term of your loan. Twenty percent (100% divided by 5 years) should be deducted in the current tax year as well as each of the four subsequent tax years. The annual 20% limit is reduced proportionally for fiscal periods that are shorter than 12 months. If loan fees are repaid before the end of the 5-year period, the remaining finance fees can be deducted upon repayment. The number of years for which you can deduct the fees is not related to the term of the loan.

With all the fees discussed above, there are often different rules for deductions under accounting law and income tax law, so it is important to consult a professional early on to ensure that the reporting is done correctly.

Creative strategies

One of the biggest perks of working with a trusted advisor like Zeifmans is the ability to utilize innovative strategies to increase ROI by increasing leverage. One such example is interest rate swapping. While it's not the right solution for everyone, when employed in the correct situation, interest rate swapping can improve contractual terms, customize financing (including prepayment and extension options), hedge future interest rate exposure, and influence loan structure at market rates with two-way breakage costs.

Financing at different stages

Another option to finance a land development project is to secure a construction loan. Unlike a traditional mortgage, a construction loan provides the money you need to complete each phase of the project as you need it. Therefore, you generally make interest-only payments (or sometimes no payments at all) during the construction period. The lender will conduct inspections throughout the process before disbursing the next installment of the loan.

3 Rezoning

Rezoning occurs during the planning stage, which means that all rezoning costs are capitalized to the property. There are several considerations when transitioning a property from one purpose to the next, and many administrative items to be addressed.

Use of land

Land use planning and municipal law dictate how a parcel of land can be used, severed, and developed. You'll need to thoroughly consult the local jurisdictional regulations to ensure that all the proper paperwork and approvals are in place prior to beginning any construction.

Severing cost

If you plan to sever – pieces of a single parcel of land for various purposes, there is a process in place to ensure that you satisfy all the local regulations.

In Ontario, this process goes as follows:

- *Consult with the municipal staff/consent-granting authority*
- *Submit complete application*
- *Consent-granting authority gives notice of the application, and potentially holds a public meeting*
- *Consent-granting authority makes the decision to grant provisional consent or to refuse*
- *Applicant is sent a notice of the decision*
- *If necessary, applicant appeals to the LPAT or local appeal body*
- *If there are no appeals, when the conditions of consent are satisfied, a certificate is issued and lots are transferred*
- *If an appeal is made, LPAT can hold a hearing or dismiss the appeal*

Change of use

If a building was already bought and treated as a capital asset when purchased, it may become inventory to the purchaser if the goal is to develop the site. Again, do your research to ensure that all regulatory requirements are met.

4 Construction

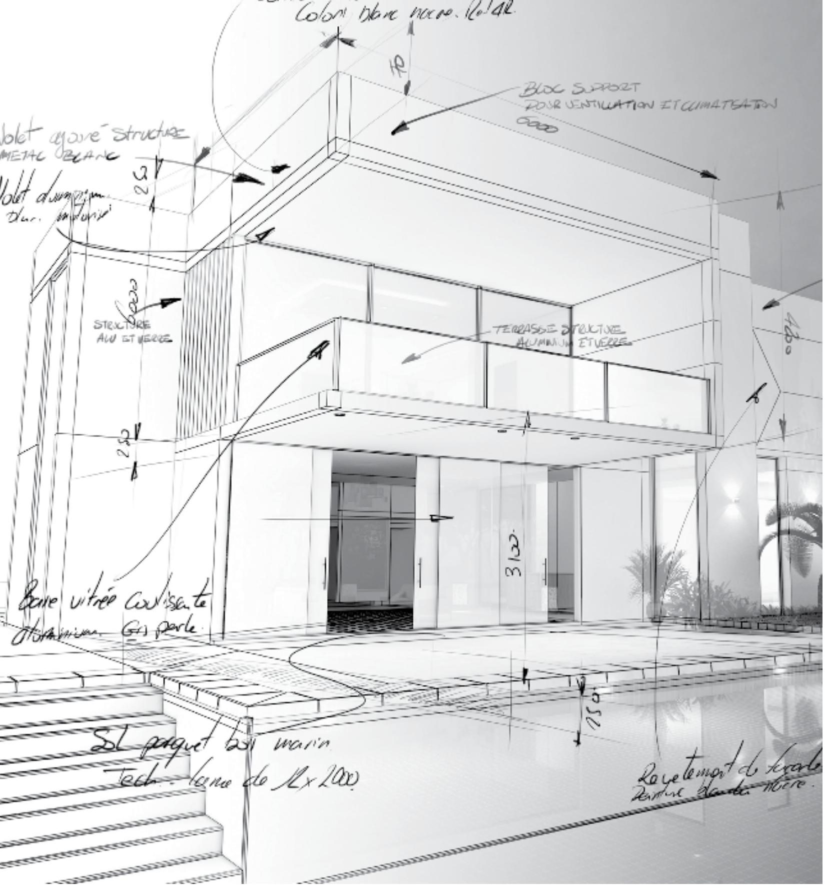
Once the construction stage begins, there are several additional considerations to ensure that the project remains on-budget and continues to maximize ROI. Earlier in this article, we touched on items like financing through construction loans, and the difference between capital versus expensing, all of which continue to apply in the construction phase. Some additional considerations during the construction phase are:

Contingencies

Anyone who has been involved in a real estate development can attest to the fact that unexpected costs often arise. A contingency allowance is a fixed amount that covers unexpected increases in costs, or changes to the work that the contractor could not be expected to know prior to beginning the work.

Environmental considerations

Environmental law issues are inextricably woven into any construction process. This is particularly true within Ontario. The Ontario Ministry of Environment has very strict regulations that must be upheld throughout the building process, lest you be saddled with unexpected fines and delays. The good news is that remaining in alignment with environmental regulations will not only save you time and money, but will also benefit the planet.



Construction soft costs

Soft costs are the fees related to construction of the building. These costs also include interest, legal fees, accounting fees, architectural fees, construction management fees, and property taxes. Soft costs may be deductible if they relate only to the alteration, construction, or renovation of the building, and if they were incurred prior to your renting out more than 90% of the building. The deduction is limited to the amount of rental income you receive from the property. Any costs that do not meet the criteria are considered capital expenses.

Bill 142

The Construction Lien Act Amendment Act (Bill 142) fully came into effect on October 1, 2019. Its purpose is to ensure that construction workers and materials providers are paid on a timely basis. The Act impacts contractors, sub-contractors, and construction projects of all sizes. In particular, the following areas now come under greater scrutiny: Invoicing, construction holdbacks, prompt payment, adjudication, and trust fund rules.

Construction holdbacks

The CRA allows holdbacks receivable to be excluded from income if the job is not complete and the amount has not yet been received from a customer. This means that a company can defer tax payments on holdbacks receivable at a future date.

Insurance

One of the most important ways to protect yourself and your investment from an unexpected loss of income is through ensuring insurance coverage is in place. When buying or renewing business coverage, you should identify your risk areas and loss exposure, have an understanding of the policy in terms of what is and isn't covered, and gather a response team who can assist you in the event that you need to make a claim.

5 Operational stage

Once the land has been developed into a functional facility, the final component of your plan can take shape. In this phase, new business deals may be brokered, presenting additional opportunities to ensure that your wealth is protected and increased.

Selling versus renting

There are advantages and disadvantages to either side of the sell/lease equation. Your decision to flip the property or to remain as a long-term landlord will be determined by a number of personal factors. Taxation is one of the factors that is especially relevant for non-resident investors. Consulting with a taxation expert can help you understand the tax implications of both options.

Commercial leases

Commercial leases are complex and legally binding agreements that should be thoroughly vetted by your established team of experts. Consider which incidental expenses you would like to pass on to your tenants, how you will manage the common areas, and whether you will allow the tenants to perform any leasehold improvements while they occupy the space.

Leasehold inducements

Leasehold inducements are payments made by a landlord to attract tenants. Depending on the location and type of property you have developed, this may be an option you want to consider. Covering moving expenses, low-rent or rent-free periods, and low-interest loans are all frequently used inducements.

6 Succession planning

If you intend to hold onto your property investment for the long-term, you will need to develop a succession plan. Many property owners make the assumption that transitioning property ownership from one generation to the next is a simple task. Unfortunately it tends to be far more complicated than we anticipate.

Succession plan advisor

Consider working with an advisor who can provide impartial advice.

Revisit the plan

As time goes on, it's important to review your plan frequently, and make adjustments as your life circumstances change. Succession planning isn't a one-time event, but instead an ongoing process that requires adjustment and consideration to ensure long-term success.

Consult with the experts

If you are considering purchasing and developing a property, reach out to the Zeifmans team early on. We can help create a structure and a strategy that will carry you through all the stages of the development, assisting you in achieving both your short-term and long-term goals.

To learn more, contact our team today at (416) 256-4000, or send us an email at info@zeifmans.ca.

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